Special Section
The ESM Before the Courts

Yes, But . . . One More Thing: Karlsruhe's Ruling on the European Stability Mechanism

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A. Introduction: The Court's Notorious "Yes, But . . ."

As in its first leading Euro-Case ("*Greece Bailout*"[1]) one year ago, the Second Senate of the Federal Constitutional Court (FCC) once again decided on the fate of Europe's bailout. The Court's *ESM* ruling on September 12, 2012, clears the path for the next steps in a fast-moving "rescue" situation.[2] This time for the ratification of three international agreements: The insertion of Article 136(3) TFEU,[3] the new Treaty establishing the European Stability Mechanism (ESM Treaty),[4] and the new Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (Fiscal Compact).[5]

The Court rejected the applications for temporary injunctions with the proviso that the ESM Treaty may only be ratified if it is ensured that the payment obligations of the Federal

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[1] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], 1 BvR 987/10, Sept. 7, 2011, 129 BVERFGE 124 (Ger.) [hereinafter *Greece Bailout* case]. *See also* Martin Nettesheim, *"Euro-Rettung" und Grundgesetz*, 46 EUROPARECHT 765, 765 (2011); Hanno Kube, *Rechtsfragen der völkervertraglichen Eurorettung*, 66 WERTPAPIERMITTEILUNGEN 245, 245 (2012); Matthias Ruffert, *Die europäische Schuldenkrise vor dem Bundesverfassungsgericht—Anmerkungen zum Urteil vom 7. September 2011*, 46 EUROPARECHT 842, 842 (2011).

[2] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], 2 BvR 1390/12, Sept. 12, 2012 ___ BVERFGE ___(Ger.), citations refer to the paragraphs of the English translation [hereinafter *ESM* case], published by the Court, available at: http://www.bverfg.de/en/decisions/rs20120912_2bvr139012en.html; they do not correspond with the different (!) number of paragraphs of the judgment [hereinafter *ESM* case (Ger.)]. See also Frank Schorkopf, *"Startet die Maschinen"—Das ESM-Urteil des BVerfG vom 12. 9. 2012*, 31 NEUE ZEITSCHRIFT FÜR VERWALTUNGSRECHT 1273, 1273 (2012); Christian Tomuschat, *Anmerkung zum Urteil des BVerfG vom 12.09.2012—BvR 1390/122—u.a.—Verhinderung der Ratifikation von ESM-Vertrag und Fiskalpakt überwiegend erfolglos*, 127 DEUTSCHES VERWALTUNGSBLATT 1431, 1431 (2012).

[3] European Council Conclusions of 24 and 25 March 2011, Annex II, 21 [hereinafter European Council Conclusions of March 2011]

[4] DEUTSCHER BUNDESTAG: DRUCKSACHEN UND PROTOKOLLE [BT] 17/9045, pg. 6 [hereinafter BT 17/9045].

[5] DEUTSCHER BUNDESTAG: DRUCKSACHEN UND PROTOKOLLE [BT] 17/9046, pg. 6 [hereinafter BT 17/9046].

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Republic of Germany from this Treaty are limited and that no higher payment obligations can be established without the agreement of the German representative legislature (*Bundestag* and *Bundesrat*).[6] Furthermore, provisions of the ESM Treaty concerning the inviolability of the documents of the ESM and the professional secrecy of all persons working for the ESM[7] must not stand in the way of the comprehensive information of the *Bundestag* and of the *Bundesrat*.[8]

This "yes, but . . ." pattern is well known from Karlsruhe's rulings concerning the European Union. Since the *Maastricht* Case in 1993,[9] the Court has never impeded but shown sensitivity for European integration. The German Court, however, has established an impressive track record calling for further involvement of the parliament in external relations and taxes and finance, including the taking of credit. The German *Bundestag* has the responsibility for integration (*Integrationsverantwortung*) and the overall budgetary responsibility (*dauerhafte Haushaltsverantwortung*).

The time frame for the decision on September 12 was unusually tight. Under regular circumstances the Second Senate would have spent at least a year deliberating the judgment. Instead the Court decided on the issue of temporary injunctions within roughly two months and had even heard oral arguments beforehand on July 10, which is considered a rare event. Under these auspices, the judgment's reasoning had to rely heavily on Senate precedent in the context of the ongoing endeavors to rescue the Euro.[10]

The following sections elaborate on the main lines of argument behind the new *ESM* judgment and put the case in the context of Karlsruhe's previous six judgments since the outbreak of the crisis in 2008. The new *ESM* judgment meets expectations and repeats much that has been said before.[11] At first sight, the court´s repetition provokes a feeling of

[6] *See ESM* case, *supra* note 2, at para. 222.

[7] *See* Treaty Establishing the European Stability Mechanism (ESM), art. 32 (5), 34, and 35 (1), Feb. 2, 2012 [hereinafter ESM treaty].

[8] *See ESM* case, *supra* note 2, at para. 228.

[9] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], 2 BVR 2134/92, Oct. 12, 1993, 89 BVERFGE 155 (Ger.) [hereinafter *Maastricht* case].

[10] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], 2 BVR 987/10, May 7, 2010, 125 BVERFGE 385 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], 2 BVR 1099/10, June 6, 2010, 126 BVERFGE 158 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], 2 BVR 1485/10, Sept. 7, 2011, 129 BVERFGE 124 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], 2 BVE 8/11, Feb. 28, 2012, 31 NEUE ZEITSCHRIFT FÜR VERWALTUNGSRECHT 495, 495 (2012) (Ger.), Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], 2 BVE 4/11, June 19, 2012, 31 NEUE ZEITSCHRIFT FÜR VERWALTUNGSRECHT 954, 954 (2012) (Ger.).

[11] *See infra* Part B.

judicial continuity. This time, however, is different; the ruling did have to cover some new ground, but omitted to reiterate important innovations from the first *Greece Bailout* case. Thus, the most remarkable part of the judgment seems to be what is missing. So Karlsruhe's latest "yes, but . . ." ruling provokes a "yes, but . . . there should have been one more thing."[12]

B. The "Yes": Connecting the Dots

The main line of reasoning of the judgment measures the three international agreements against the standards of review developed by the Court in *Greece Bailout* and in the first *ESM* Case.

I. The Extent of Review

Departing from the scrutiny usually applied in temporary injunction proceedings, the Second Senate applied the standard of a summary review of the three challenged Acts of assent and of the accompanying laws asking whether these jeopardize the applicants' rights.[13] The usual extent of review in temporary injunction proceedings would have forced the Senate to rely on a mere weighing of the consequences of its decision. Against the background of the binding effect of the ratification of the Treaties, a mere weighing of the consequences would have strongly suggested issuing temporary injunctions, which is no easy option for the Court during times when many critics are under the impression that Germany should be acting more quickly and zealously to avoid a collapse of the euro zone.[14]

II. The Standard of Review

As it had been in the *Greece Bailout* case, the Court's constitutional assessment was based on Article 38(1) of the Basic Law.[15] The Senate regarded the principal proceedings as admissible to the extent that the applicants asserted a violation of the overall budgetary responsibility of the German *Bundestag*, which is entrenched in constitutional law through

[12] *See infra* Part C.

[13] *See ESM* case (Ger.), *supra* note 2, at para. 190–94.

[14] This extent of review is, however, already known from other constellations. *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], 2 BvQ 5/77, Oct. 16, 1977, 46 BVerfGE 160, 194 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], 2 BvR 617/84, May 30, 1984, 67 BVerfGE 149, 151 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], 1 BvQ 19/04, June 23, 2004, 111 BVerfGE 147, 153 (Ger.).

[15] Grundgesetz für die Bundesrepublik Deutschland [Grundgesetz] [GG], art. 38 (1) ("Members of the German Bundestag shall be elected in general, direct, free, equal, and secret elections. They shall be representatives of the whole people, not bound by orders or instructions, and responsible only to their conscience.").

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the principle of democracy (Article 20(1) and (2),[16] and Article 79(3)[17] of the Basic Law). The *ESM*'s standard of review is nearly identical to the standard of review developed in *Greece Bailout*, which is used as a kind of boilerplate.[18]

1. The "Budgetary Responsibility" Complaint

The "budgetary responsibility" complaint was the main innovation of the *Greece Bailout* case.[19] Procedurally based on Article 38(1), Article 20(1 and 2), and Article 79(3) of the Basic Law, this complaint redefines the structurally twisted argument of "protecting the *Bundestag* against its own decisions." It is understood as a protection of certain aspects of the right to vote, including the preservation of the democracy principle,[20] guaranteed in Article 79(3) of the Basic Law as part of the unchangeable identity of the constitution.[21]

The Court pointed out "the prohibition of the relinquishment of budgetary responsibility does certainly not impermissibly restrict the budgetary competence of the legislature, but is specifically aimed at preserving it."[22]

The "budgetary responsibility" complaint bridges the gap between two heterogeneous aspects of the constitutionally guaranteed right to vote. On the one hand, this right does not generally "serve to monitor the content of democratic processes, but is intended to facilitate them."[23] On the other hand, the right to vote can be violated if the *Bundestag's* competence is substantially curtailed and thus a "loss of substance occurs of the

[16] Grundgesetz für die Bundesrepublik Deutschland [Grundgesetz] [GG], art. 20 (1) ("The Federal Republic of Germany is a democratic and social federal state. (2) All state authority is derived from the people. It shall be exercised by the people through elections and other votes and through specific legislative, executive, and judicial bodies.").

[17] Grundgesetz für die Bundesrepublik Deutschland [Grundgesetz] [GG], art. 79 (3) ("Amendments to this Basic Law affecting the division of the Federation into Länder, their participation on principle in the legislative process, or the principles laid down in Articles 1 and 20 shall be inadmissible.").

[18] The *ESM* standard of review can be found at *ESM* case (Ger.), *supra* note 2, at paras. 209–28. Identical wordings can be found at *Greece Bailout* case, *supra* note 1, at paras. 120–32: see paras. 210/121–22, 211/124, 212/125, 213/127, 214/128, 216/131, 216/135, 217/132, 219/137, 219/129, 220/129, and 224/104.

[19] Four (out of five) headnotes of the judgment address the "budgetary responsibility" (No. 1, 2, 3 and 5). *See Greece Bailout* case, *supra* note 1, at paras. 96–102 and 121–32.

[20] Within the meaning of Article 20 (1) and 20 (2) of the Basic Law.

[21] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], 2 BvE 2/08, Oct. 30, 2009, 123 BVerfGE 267, 340 (Ger.) [hereinafter Lisbon case].

[22] *Greece Bailout* case, *supra* note 1, at para. 125.

[23] *See id.* at para. 99.

democratic freedom of action for the constitutional body which has directly come into being according to the principles of free and equal election."[24]

By relying on the "budgetary responsibility" the complainants claim that "the sustained (long-term) budgetary autonomy of the German *Bundestag* is violated in the sense of the erosion of its competences." This constitutes a sufficient substantiation of a violation of their subjective rights.[25]

2. The "Measures Transgressing the Framework of Authorization" ("Ultra-Vires Review")

A surprising aspect of the standard of review is the Court's remark dealing with the rescue measures taken by the European Central Bank. The Second Senate gave considerable attention to one of the applicants' objections to these rescue measures, in particular to the acquisition of government bonds on the secondary market. A constitutional assessment of these measures can only be based on the argument that the ECB's measures transgress the framework of authorization established by the German Acts of assent to the European Union Treaties ("ultra-vires review"). The Court explicitly holds that this objection is not encompassed by the application for a temporary injunction, but that it would be reviewed in the principal proceedings.[26]

This path of ultra vires review seems questionable. One obvious problem is connected with the previous *Euro* Case (*Greece Bailout)*. In this judgment, the Second Senate treated an identical ultra-vires objection against nearly identical ECB rescue measures as inadmissible.[27] But regardless of this leading case, the question has a much more fundamental character. The German Constitutional Court has never before treated a so-called "principal ultra-vires objection" ("*prinzipale ultra-vires Rüge*") as admissible.

The idea of such a *principal* ultra-vires objection would assume that the German Court *generally* watches over European acts transgressing the framework of authorization established by the German Acts of assent to the European Union Treaties—without the complainants needing to submit with sufficient substantiation that they themselves are presently and directly affected by a violation of a fundamental right or a right equivalent to a fundamental right. The Honeywell Case of July 6, 2010, the only ultra-vires review by the German Constitutional Court, leaves the question whether principal ultra vires reviews would be admissible at all unanswered. In this case there were some other fundamental

[24] *See id.* at para. 100.

[25] *See Greece Bailout* case, *supra* note 1, at para. 97.

[26] *See ESM* case (Ger.), *supra* note 2, at para. 202.

[27] *See Greece Bailout* case*, supra* note 1, at para. 113.

rights directly affected so the decisions did not depend on this question.[28] The complainant in the *Honeywell* case asserted a violation of its rights under Article 2.1 and Article 12.1 in conjunction with Article 20.3 and Article 101.1, sentence 2, of the Basic Law.

If the Second Senate conducted an ultra-vires review in the principal proceedings, the rules of procedure laid down in *Honeywell* would require cooperation with the European Court of Justice, because:

> Prior to the acceptance of an ultra vires act, the Court of Justice of the European Union is to be afforded the opportunity to interpret the Treaties, as well as to rule on the validity and interpretation of the acts in question, in the context of preliminary ruling proceedings according to Article 267 TFEU, insofar as it has not yet clarified the questions which have arisen.[29]

3. Accidentally Beyond the Maastricht *and* Lisbon *Standard of Review?*

The second surprise concerning the standard of review is the Court's self-restraint compared to the usual standard of review in cases concerning German Acts of assent to the European Union Treaties, in particular, the structure of the monetary union (*Maastricht,*[30] *Third-Stage-of-the-Euro-Introduction,*[31] *Lisbon*[32]). Whereas Article 88 of the Basic Law provides the Second Senate's usual standard for the constitutionality of the monetary union's design, the latest ruling only takes the concept of "overall budgetary responsibility of the German *Bundestag*" into account. Article 88 of the Basic Law is not even mentioned.[33]

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[28] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], 2 BvR 2661/06, July 6, 2010, 126 BVERFGE 286 (Ger.) [hereinafter *Honeywell* case].

[29] *See id.* at para. 60 and Headnote 1. b).

[30] *See Maastricht* case, *supra* note 9.

[31] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], 2 BvR 1877/97, Mar. 31, 1998, 97 BVERFGE 350 (Ger.) [hereinafter *Euro* case].

[32] *See Lisbon* case *supra* note 21.

[33] *See*, however, *ESM* case, *supra* note 2, at para. 203, but this does not describe a standard of review.

III. Subsumtion

The subsumtion contains three parts, the Act of assent to the insertion of Article 136(3) TFEU, the Act of assent to the ESM Treaty, and the Act of assent to the Fiscal Compact.

First, the Second Senate holds, that the Act of assent to the insertion of Article 136(3) TFEU does not impair the precept of democracy.[34] The Article would change the present design of the economic and monetary union, but the commitment of the Member States to observe budgetary discipline would remain intact.[35] This (short) part of the judgment is crucial and will be discussed in the next section.[36]

Second, with regard to the Act of assent to the ESM Treaty, the court concludes that this is essentially consistent with the requirements set forth by constitutional law with regard to safeguarding the overall budgetary responsibility of the German *Bundestag*.[37]

Finally, the court is of the opinion that the Act of assent to the Fiscal Compact does not violate the overall budgetary responsibility of the German *Bundestag*.[38]

C. The "But": There Would Have Been "One More Thing"

This time, the Second Senate's famous "yes, but . . ." formula itself calls for a caveat—a "yes, but . . .". The ruling needed to cover new ground, but instead the Senate failed to expand on its own innovations from the *Greece Bailout* case.

There was one more thing, which the Court did not do: Measuring the insertion of Article 136(3) TFEU against the "mechanism" line of argument. This subtext makes the missing part of this judgment probably the most interesting omission in the history of the FCC.[39]

Parts I, II, and III elaborate on *what* exactly is missing, Part IV explains *how* that matters, and Part V offers an educated guess on *why* it is missing.

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[34] *See ESM* case (Ger.), *supra* note 2, at paras. 231–38.

[35] *See ESM* case (Ger.), *supra* note 2, at para. 233.

[36] *See infra* Part C.

[37] *See ESM* case, *supra* note 2, at paras. 208–48.

[38] *See ESM* case (Ger.), *supra* note 2, at paras. 300–19.

[39] The most interesting omission in the history of the Court's dissenting opinions would still be represented by dissenting Justice Zeidler's opinion "I do not agree.", see 77 BVERFGE 167 (Ger.)

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I. The "Mechanism"—Line of Argument

The "mechanism" line of argument was the intellectual core and the key innovation of the first Euro judgment, the *Greece Bailout* case of September 7, 2011.[40] In this case, the Second Senate held that the German *Bundestag* may not transfer its budgetary responsibility to other entities.[41] In particular, the German *Bundestag* may not assent to *any mechanisms with financial effect* which—whether by reason of their overall conception or by reason of an overall evaluation of the individual measures—may result in incalculable burdens with budgetary significance without prior parliamentary consent.[42]

The premise behind this "mechanism" argument, which premiered in *Greece Bailout*, is the concept of electoral democracy: "There is a violation of the right to vote if the German *Bundestag* relinquishes its parliamentary budget responsibility with the effect that it or a future *Bundestag* can no longer exercise the right to decide on the budget on its own responsibility."[43] This constitutional premise has been well known for years. In the past, this premise was the standard for the Court's assessment of the constitutional limits provided by the Basic Law to prevent Parliament from limiting its own right to decide on the budget.[44]

The "mechanism" argument in *Greece Bailout* has now offered a new perspective on these well-known limits to the transfer of competences, which derive from the idea of electoral democracy. Whereas in the past the Court had only assessed questions arising from explicitly formal transfers of the competence of the *Bundestag* to adopt the budget to the European Union, the new "mechanism" line of argument drew another conclusion. Even *without* formal transfers of budgetary competences, the substantive content of the principle of democracy can actually be violated if the *Bundestag* depletes its right to decide on the budget in a constitutionally impermissible manner.[45]

[40] *See Greece Bailout* case*, supra* note 1, at paras. 125–28 headnotes 3a ("The German Bundestag may not transfer its budgetary responsibility to other actors by means of imprecise budgetary authorisations. In particular it may not, even by statute, deliver itself up to any mechanisms with financial effect which—whether by reason of their overall conception or by reason of an overall evaluation of the individual measures—may result in incalculable burdens with budget relevance without prior mandatory consent.") and 3b ("No permanent mechanisms may be created under international treaties which are tantamount to accepting liability for decisions by free will of other states, above all if they entail consequences which are hard to calculate. Every large-scale measure of aid of the Federal Government taken in a spirit of solidarity and involving public expenditure on the international or European Union level must be specifically approved by the Bundestag.").

[41] *See Greece Bailout* case*, supra* note 1, at para. 125; *ESM* case, *supra* note 2, at para. 196.

[42] *See Greece Bailout* case*, supra* note 1, at para. 125; *ESM* case, *supra* note 2, at para. 196.

[43] *See Greece Bailout* case*, supra* note 1, at para. 121.

[44] *See Maastricht* case, *supra* note 9, at para. 172; *Euro* case, *supra* note 31, at paras. 368–69.

[45] *See Greece Bailout* case, *supra* note 1*,* at para. 133.

Beyond the well-known questions of formal transfers of budgetary competences, the Second Senate addressed two different aspects in the *Greece Bailout* case: (1) a prohibition to burden present or future federal budgets with disproportionately great commitments, and (2) mechanisms with adverse consequences for the German *Bundestag's* budget autonomy.[46] Both facets (disproportionately great commitments *and* mechanisms) covered new ground in the *Greece Bailout* case. They have to be thoroughly distinguished.

The Second Senate differentiated as follows:

An *upper limit* to issuing financial guarantees following directly from the democracy principle can only be assessed if the guarantee affects budget autonomy in such a way that it, at least for an appreciable period of time, is not merely restricted but effectively fails.[47] *A mechanism*, however, can create or consolidate an automatic effect that may result in the relinquishment of the German *Bundestag's* right to decide on the budget.[48]

The concept of legal obligation is the crucial difference between the Court's two new categories. A "mechanism" is entirely different from a legal obligation. If there were explicit legal obligations, the Court would not have needed the "mechanism" line of argument, but could have only assessed the upper limit of guarantees.

So what is a "mechanism," if it is not a legal obligation? In *Greece Bailout* the Court offered no definition, but the "mechanism" line of argument gives the following answer: A mechanism is everything that has an effect *similar to a transfer* of budgetary competence (otherwise it would be a transfer) *without establishing legal obligations* (otherwise it would be a legal obligation).

II. It Takes an Architect to Catch a "Mechanism"

With a view to this *Greece Bailout* overture, the biggest surprise by far in the *ESM* judgment is the Second Senate's cavalier way of handling its delicate "mechanism" line of argument. Readers searching for a careful analysis of each "mechanism" entangled in the three challenged international agreements will be disappointed by the judgment.[49] The

[46] The *Greece Bailout* judgment also calls these mechanisms "irreversible processes" or "automatic effects", *see Greece Bailout* case*, supra* note 1, at paras. 127, 136–37.

[47] *See Greece Bailout* case*, supra* note 1, at para. 135.

[48] *See id.* at para. 136.

[49] *See* European Council Decision of 25 Mar. 2011, amending Article 136 of the Treaty on the Functioning of the European Union, OJ 2011, L 91/1; ESM Treaty, *supra* note 7; Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, Mar. 2, 2012; *see also* Press Release, Federal Constitutional Court,

Second Senate relied on Potter Stewart's principle "I know it when I see it." This is worth taking a closer look. Assessing the problems at hand, it becomes evident that the Senate addressed just one out of two mechanisms.

The mechanism dealt with is blatantly obvious, because it is called the "European Stability Mechanism." In the meantime the other—far more important—mechanism though remains unaddressed in the judgment.[50] It arises from the freshly modified Treaty on the Functioning of the European Union.

The insertion of new Article 136(3) TFEU, which the FCC gave only little attention, has the following wording: "(3) The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality."[51] Looking at the content and context of this new Article, the Court would have been expected to deal with complainants' submissions and then to investigate the details of the underlying mechanisms. The Second Senate belied this expectation. The Court's reasoning contains no substantial sections discussing Article 136(3) TFEU at all.

The challenge here derives from what is known as the "framing effect."[52] Despite the fact that new Article 136(3) TFEU openly refers to some other (secondary) mechanisms, the modified architecture of the European monetary union itself can be framed as a (primary) mechanism.

The Second Senate, however, does not assess the insertion of this Article in its primary effect. Instead, the Court describes Article 136(3) TFEU as "merely opening up the possibility of installing a mechanism on the basis of an international agreement."[53] Article 136(3) TFEU itself, the Court concludes, does not establish such a stabilization mechanism.[54]

Applications for the Issue of Temporary Injunctions to Prevent the Ratification of the ESM Treaty and the Fiscal Compact Unsuccessful for the Most Part (Sept. 12, 2012) (which does not mention article 136 (3) TFEU).

[50] *See* Christian Tomuschat, *Anmerkung zum Urteil des BVerfG vom 12.09.2012—BvR 1390/122—u.a.—Verhinderung der Ratifikation von ESM-Vertrag und Fiskalpakt überwiegend erfolglos*, 127 DEUTSCHES VERWALTUNGSBLATT 1431, 1433 (2012) (which does not notice this omission).

[51] European Council Conclusions of March 2011, *supra* note 3.

[52] *See* Amos Tversky & Daniel Kahneman, *The Framing of Decisions and the Psychology of Choice*, 211 SCIENCE 453, 453 (1981).

[53] *See ESM* case (Ger.), *supra* note 2, at para. 236.

[54] *See ESM* case (Ger.), *supra* note 2, at para. 236.

The problem with "mechanisms" is that the world is full of them. However, some of them are hidden. Therefore one should consider carefully, whether or not to hold something to be "merely opening up some possibility." Most legal rules cannot be properly assessed when seen against only one layer of the legal order.

However, taking the framing effect seriously, the problem at hand is about different framings of the new Article 136(3) TFEU. These different framings remain possible even if the Second Senate frames the insertion as a "mere possibility of installing a mechanism." There is at least one more important possibility, which should be analyzed in the next section: the new Article can be framed as an integral part of a sequential move mechanism.

III. The Monetary Union as a Sequential Move Mechanism

The mechanism behind Article 136 TFEU, now modified by the insertion of Article 136(3), is the monetary union mechanism.

The first problem here is obviously to avoid the pitfalls of "falsa demonstratio." Of course, the Second Senate has not built its mechanism line of argument on labels—but on the substance of the mechanism at hand. The question is *what* actually is a "monetary union" rather than *how* to call a "monetary union." Legal analysis of possible mechanisms cannot entirely be based on the observation, that a system of rules is called "monetary union" instead of "monetary union mechanism" (which would certainly make it easier to recognize at first glance).

The monetary union is a mechanism, which can be described and analyzed as a sequential move mechanism. So what is a "sequential move" mechanism?[55] The main feature of a sequential move setting is that the moves (choices) of the different actors are not performed simultaneously but sequentially. In this sense the monetary union is a "sequential move" mechanism, because there are actors (Member States or groups of Member States) moving first and other actors (Member States or groups of Member States) moving second.

The decisive point of such a strategic situation is, however, not time, but information. What makes the monetary union's system of rules a sequential move mechanism is not simply that one actor moves first and another actor moves second. What really makes the monetary union a sequential move mechanism is that the second actor *knows* what choice

[55] Game theorists might prefer the label "sequential move game" instead. *See* ULRICH ROLF, FISKALPOLITIK IN DER EUROPÄISCHEN WÄHRUNGSUNION. MARKTDISZIPLINIERUNG, TRANSFERS UND VERSCHULDUNGSANREIZE 74 (1996); Stefan Magen, *Spieltheorie, in* ÖKONOMISCHE METHODEN IM RECHT 71 (Emanuel V. Towfigh & Niels Petersen eds., 2010); James M. Buchanan, *The Samaritan's Dilemma*, *in* ALTRUISM, MORALITY, AND ECONOMIC THEORY 71 (Phelps ed., 1975).

the first actor has made, before the second actor gets to make his own move. This information architecture makes the mechanism work. So it is not the timing *per se* that matters, but the fact that the second actor has observed the first actor's choice before making his own. And vice versa, the first actor knows about the second actor's later knowledge.

Generally speaking, in a "sequential move" mechanism, the second actor knows the first actor's choice before the second actor chooses, and the first actor knows that this will be the case.

The "mechanism" results because the first actor puts himself in the shoes of the second actor, whose decision it precedes. This requires anticipation; actors look—down the decision tree—to what actors deciding later will do. This kind of anticipation has influence on the first movers since their payoffs can essentially depend on second movers' decisions. Thus, the first movers make their choices anticipating the second movers' choices.

This *choice-depending-on-anticipation*-pattern is the part of the sequential move mechanism, where the famous "incentives" enter the stage. It is a common misunderstanding that these incentives are "carrots and sticks," influencing the actor who decides under their impression. There is some truth to that, but much more important is the incentives' influence on the anticipation—and, therefore, on the choices—of other actors. The incentive scheme for the second actor is the foundation of the first actor's anticipation, a major factor of which is *incentives other actors will have*. So, as said before, the actors look down the decision tree to make their choices.

The difficulty here is to see the range of incentives in sequential move mechanisms, since the change of incentives for one actor *can* change the behavior of other actors. In strategic situations the incentives for one actor are connected to the behavior of others via their anticipations. This is where the often-mentioned problem called "moral hazard"[56] comes from.

1. A Problem Called "Moral Hazard"

Sequential move mechanisms *can* have negative effects, such as "moral hazard." This problem *can* occur, when the payoffs for each actor depend on other actors' choices, which is obviously the case in the monetary union.[57] It works as follows: the first actor knows his choice (A or B) and anticipates the second actor's choice (Y or Z). The first actor's

[56] See KENNETH DYSON &LUCIA QUAGLIA, 2 EUROPEAN ECONOMIC GOVERNANCE AND POLICIES 371 (2010).

[57] For example the fact that the interconnection of the capital markets has greatly increased or the effects of economic contagion, which the payment default of one state in the monetary union has on the other Member States.

knowledge about the second actor's incentives is the foundation for his anticipation.[58] If the incentives for the second actor are obvious, the first actor anticipates the corresponding choices. At the same time, the individual payoffs for both actors depend on the other actor's choice, so the individual payoffs are different, depending on what kind of combination of choices there is.[59]

Moral hazard occurs, if the incentives for one actor are clearly in favor of one choice, that guarantees him high payoffs, but leads to low payoffs for the other actor. In this situation the first actor anticipates the second actor's later choice and tries to avoid this outcome, because his payoff is threatened to be low. So the first actor's choice evades this situation by choosing the other option. This can be "bad" in the sense that the other option leads to a combined outcome (first actor's payoff combined with second actor's payoff) worse than the combined outcome of the other option. Simply speaking, moral hazard can lead to individual choices that are bad for the "combined outcome." Moral hazard, however, is not given by nature. It results from the design of the decision tree, in particular, from the corresponding incentive scheme.

2. Changing the European Treaties as Incentive Design

Given the structure of the monetary union as a sequential move mechanism, the legal framework can be analyzed as shaping the incentives for every single actor. More poignantly, changing the legal framework by the insertion of Article 136(3) TFEU can be analyzed as changing the incentive design of the whole mechanism. The greater idea behind the incentive design of the monetary union is commitment.

Although there are, of course, other important commitment strategies,[60] one interesting kind of commitment is the reduction of options. Only analyzing the monetary union as a sequential move mechanism makes it possible to understand the curiosity how *getting rid of some choices* can make someone (or even everyone) better off. The reason for this is that getting rid of choices can change the *behavior of others*, because it can change their *anticipations*. And such a change can benefit everyone. And the other way round, if getting rid of options did not change the behavior of others in a good way, it would not be worth trying.

This is the key idea why it can be crucial whether there is "a mere possibility" or not, because "getting rid of choices" is equivalent to "there is no mere possibility of . . . ."

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[58] Such as "When I choose A, second actor will choose Y, when I choose B, second actor will choose Z."

[59] A combined with Y, A combined with Z, B combined with Y or B combined with Z.

[60] Another kind of commitment is based on "collaterals"; *see infra* section 4.

Getting rid of some choices can be a mighty commitment strategy. And vice versa: Reintroducing the "mere possibility" changes the commitment again.

From this point of view, the critical feature of Article 136(3) TFEU is the *destruction* of stabilized anticipations, which have been resulting from a textbook example of "getting rid of options," the no-bailout principle. The new Article opens the door to establishing a permanent mechanism(s) for mutual help and is therefore a game changer for the incentives of every single member of the monetary union. The resulting new framework modifies the incentive scheme in a sequential game.

3. "No Bail-Out" as a Commitment Strategy

The no-bail-out clause, which is now being abolished by the insertion of Article 136(3) TFEU, has been a commitment strategy. To be more precise, it has been a commitment strategy for every Member State except the 250-pound-gorilla among Europe's economies.

The legally binding promise not to grant any mutual financial aid has been a strong commitment to encouraging fiscal discipline.[61] The disclaimer against mutual financial aid has crucially changed the political payoffs for Member States deciding whether to comply with rules of fiscal discipline. As long as hope for financial assistance from other Member States is not a realistic option, domestic policy decisions could justify the pain of budgetary discipline as necessary to avoid potential threats of losing access to the markets for governmental bonds (which is a permanent threat as long as governmental budgets remain unbalanced).

The Member States, therefore, only had the choice between "painful" short-term consolidating measures resulting from budgetary discipline and (the potentially even greater) long-term "pain" as a consequence from losing access to "the markets". In other words: the Member States could justify their imminent political costs for strict compliance with fiscal discipline as avoiding the political costs that would otherwise result from looming state defaults.

The no-bail-out principle hands out one piece of important information to the Member States: some kind of political costs are inevitable, either short-term or long-term.

Everything changes if there is hope for financial aid, [62] because as soon as there is hope for bailouts, there are no *inevitable* costs that must be paid by one's own population. Therefore, payoffs for domestic policy decisions are completely different if there is "a path

[61] *See* Treaty on the Functioning of the European Union, art. 123–26, 136.

[62] That is to say that the mere legal possibility of implementing such a scheme *in the future* suffices to change the *present* framework.

to light," a path to bailouts. A new way diverges when domestic fiscal policy has to make a choice between the constraints of budgetary discipline and the political costs of getting someone else (other Member States, the European Central Bank, etc.) to grant bailouts. This choice is something completely different from the choices under the no-bail-out rule, because domestic policy can minimize its costs for bailouts by minimizing its "service in return." The political costs for bailouts are not decided by nature; rather, they are negotiated between the Member States. In democratic societies this detail puts domestic policy under enormous pressure. The simple question is: Why should a government cut pensions and sack public servants if they can negotiate a bailout instead?

It is important to see the no-bail-out principle as this kind of commitment strategy. It enables domestic policy to comply with fiscal discipline in democratic societies. The relinquishment of mutual help is a mighty tool that domestic politicians need to change the incentives for their own population in favor of budgetary discipline. The subtle point here is to view the importance of the no-bailout clause for domestic policy, rather than to see it as some kind of protection for the bailing out Member States. From this point of view, the no-bailout principle is more "Cortés burning his ships to prevent further mutiny,"[63] than Charles Dickens's "Ebenezer Scrooge's disgust for the poor and lack of charity." It is simply not about solidarity, but about incentive design.

So getting rid of the bailout option is a commitment strategy for domestic politics in democratic societies and is necessary to align the voters' interest with the interest of fiscal discipline. It is the lack of a bailout option that makes it credible that a breach of fiscal discipline might result in state default. Without this "credibility-device" the democratic process inevitably leads voters to question, "why should we keep our faith with a government that cuts pensions and sacks public servants, if we could vote for a government that can negotiate a bailout instead?"

Coming back to the above mentioned 250-pound-Gorilla, the no-bailout principle is a commitment strategy for every single Member State, except the strongest economy in the Euro-Zone, which is too big to be saved by others. This, however, does not change the gorilla's incentives, because the effect of the no-bailout clause is substituted by the size of the economy. So "the gorilla" is committed to the rules of budgetary discipline either way.

[63] Whether it is a historic truth or not, the story, however, tells about the military commander Cortés during the Spanish conquest of the Aztec Empire, that he actually burned his ships—that is, he willingly reduced his options (commitment strategy)—in order to "strengthen" his soldiers' incentives for fighting under his command instead of running away. The story is especially instructive given the fact, that Cortés was much less susceptible to his men's interests than democratic governments are to their voters' interests.

4. "Collateral" as a Commitment Strategy

"Getting rid of choices" is just one example of a powerful commitment strategy which has played a major role in the monetary union's incentive design. Issuing "collateral" is another kind of important commitment strategy, which is worth taking a closer look at and should be mentioned when discussing the *ESM* Case.

Several times during the current sovereign debt crisis there were some odd politician's words demanding "collateral" to give at least some security (such as gold or even more unrealistic, "islands popular with tourists") to the Member States bailing out the periphery—without success, of course. Such refusal notwithstanding, collateral has not been barred from gaining more and more influence on the behavior of the Member States and the markets.

The collateral one has to take into account, though, is not the collateral the periphery needs to provide, but the collateral the bailing-out Member States give in the form of their guarantees.[64] That looks peculiar at first glance, because the bailing out Member State seems to be the lender and a lender usually does not issue collateral; the borrower does. But the whole picture is slightly larger; in particular, one has to consider "the markets." These markets invest in governmental bonds of the periphery (through the vehicles formerly known as "European Financial Stability Facility,"[65] for the future re-branded as "European Stability Mechanism"[66]), they are "the lenders," and they receive the collateral issued by the bailing out Member States in the form of the guarantees.

There is a subtlety worth taking note of in the way this collateral works. One might think the important thing is that collateral makes the lender ("the market," that is, the investors) feel safer. There is some truth to that. But for the mechanism that's actually not the key. Frankly, most lenders do not want the collateral; they would rather invest somewhere else (that is part of the problem). The way in which the collateral works is not that it gives an extra positive return to the lender, but an extra negative return to the borrower, the bailing out Member State.

So the way in which the collateral has been working so far is by hurting the borrower enough in the event of a future default of periphery Member States. That changes the incentive scheme. By issuing the collateral, the bailing out Member States lower their payoffs in certain endpoints of the future decision tree (potential future defaults). This mechanism changes the behavior of the borrower (the bailing out Member State), by

[64] In fact, the problem of the *Greece Bailout* case has exactly been this kind of collateral.

[65] *See Greece Bailout* case*, supra* note 1, at paras. 16–31; *ESM* Case, *supra* note 2, at paras. 4–6.

[66] *See ESM* case, *supra* note 1, at paras. 11–75.

inducing it to bail out again (and again). This of course changes the choices of all players in the sequential move game, because the other Member States' anticipations on future bail out decisions are changed together with the incentives.

The fast growing collaterals within the monetary union are part of a larger commitment strategy, which is gaining more and more influence on future political decisions. The Second Senate addresses the different topics involved for Germany quite clearly. These are "the German participation in the European Financial Stability Facility, bilateral assistance in favor of Greece and risks resulting from the participation in the European System of Central Banks[67] and in the International Monetary Fund."[68] Interestingly enough, the Second Senate discusses the problems arising from the commitment strategy—with just one sentence in the judgment—as "risks being manageable." But to be clear in this point, "risk" means bad things can happen but they do not need to. The growing collaterals' important effect is, however, that they are an influential factor, which changes the payoffs and incentives for every Member State in the monetary union permanently. This permanent change is not a risk but a certainty.

5. Summing Things Up

To sum things up, there is a future incentive design of the monetary union that combines two different commitment strategies. On the one hand, the stronger commitment of the bailing out Member States makes it less likely that they refuse future bailouts ("collateral").[69] On the other hand, the commitment strategy of the bailed out Member States goes the other way round, because they have fewer incentives to comply with the rules on budgetary discipline.[70] There is even a connection between the two mentioned commitment strategies. The stronger commitment in favor of future bailouts is part of the incentive scheme, which the periphery builds their anticipations on when assessing the risks of not complying with the fiscal rules.

[67] These risks are in particular connected with the ECB's so called "Target2-System," discovered and made public by Hans-Werner Sinn, who already mentioned this problem during the oral hearing on 5 July 2011 in the *Greece Bailout* case.

[68] *ESM* case, *supra* note 2, at para. 240.

[69] *See supra* Part C(III)(4).

[70] *See supra* Part C(III)(3).

IV. Does It Matter?

Should we take care of sequential move mechanisms and incentive design at all? Maybe the Second Senate was wrong in *Greece Bailout* when taking mechanisms into account. One might argue that written legal obligations are good enough, at least they can be analyzed much easier.

Unfortunately, the incentive design of the monetary union is of utmost importance. Ever since the first negotiations on the Maastricht Treaty, it was clear that the enormous forces of colliding economic interests would need to be hedged. The colliding interests among the different Member States would somehow have to be aligned. If budgetary discipline does not serve the self-interest of all Member States, national political systems lack the capability to impose heavy burdens on their populations.

Taking these forces into account, it is simply not enough to write down some legal obligations. There are, of course, legal obligations that are self-enforcing, because they demand decisions that Member States are interested in. But that is not given by nature because the Member States are responsible for designing the incentive schemes involved. Although rule compliance is often ascertainable, budgetary decisions of Member States take place in human societies as they actually exist, in other words, "in the real world where people live and work and die."[71] The history of the monetary union provides an illustrative narrative on rule compliance.

1. The Pre-Maastricht Negotiating Process

However, in the pre-Maastricht negotiation process, no serious discussion referred to a proposal comparable to the new design of the monetary union. There were two competing models discussed instead: One model relying solely on the right incentive scheme ("marked-discipline mechanism"); another model that relied on well-designed incentives ("marked-discipline mechanism") *and* legal obligations on budgetary discipline.[72]

A model without smart incentives for rule compliance ("market-discipline mechanism") based only on legal obligations has never been seriously discussed. Until now.

[71] *See* Appellate Body Report, *European Communities—Measures Concerning Meat and Meat products*, WT DS26/AB/R, para. 187. (Jan 16, 1998).

[72] *See generally* KAI HENTSCHELMANN, DER STABILITÄTS UND WACHSTUMSPAKT 1495 (2009).

2. The "Pull to Compliance"

In effect, the new architecture of the monetary union provides for an incentive scheme that weakens the "pull to compliance" for many Member States. Worse than the weakened pull to compliance is the loss of a common interest. Budgetary discipline is no longer a self-interest of all Member States (thereby amounting to a common interest), but a "mere rule" that is imposed on the Member States in need of financial bailouts. As a mere legal obligation (that frustrates domestic political agendas and that is sharply criticized by supporters of a Keynesian economic policy), budgetary discipline enters the battleground of the political process. The "pull to compliance" is important. The Senate holds that strict compliance with European treaties guarantees that the European Union's acts affecting Germany are democratic and legitimate.[73]

3. The Future Timeline

In the mid- and long-term perspective, any hope of negotiating away these conflicts seems foolhardy considering the underlying political forces. As of June, more than half of all Greeks under the age of 25 were without work. In the whole euro-area there was an increase of 2 million unemployed this year. This problem will intensify as some Member States may leave the regular markets for government bonds for a long time.

The two commitment strategies discussed above strengthen the incentives for some Member States to not comply with budgetary discipline rules. And they strengthen the incentives for some other Member States to grant bailouts. Does this affect the budget? It is hard to see how it could not.

4. Anyway: What is Budgetary Discipline Good for at All?

Leaving all these aspects aside, one simple question remains: Why should someone worry about fiscal discipline at all? What is it good for?

There are rules demanding fiscal discipline, but what are the rules good for? The Second Senate, of course, stresses the importance of budgetary discipline for budgetary responsibility.[74]

Another point is the commitment to guaranteeing stable prices in the monetary union. In a monetary union based on stability it is a cardinal duty of financial policy to ensure that sound state finances support monetary policy.

[73] *See Maastricht* case, *supra* note 9, at page 199; *Euro* case, *supra* note 31, at page 373; *Greece Bailout* case, *supra* note 1, at para. 129; *ESM* case, *supra* note 2, at para. 203.

[74] *See Greece Bailout* case*, supra* note 1, at para. 129; *ESM* Case, *supra* note 2, at para. 203.

Compliance with the rules of fiscal discipline is an essential condition for stable prices. An institutional framework where the European Central Bank can guarantee stable prices in the monetary union must be supported by sound state finances.

V. Could the Senate Not Have Noticed?

How was it possible for the Court not to mention the most important mechanism involved in the *ESM* case, the mechanism implicit in any ex ante crisis scheme? The answer is: Given the facts, it was impossible for the Court to overlook this point.

1. "Task Force" Established by the March 2010 European Council

The "Task Force" established by the March 2010 European Council previously addressed the problem clearly in its Final Report:

> Since the creation of the Task Force, the European Financial Stability Facility (EFSF) for the euro area and the European Financial Stability Mechanism (EFSM) [. . . offer] a good line of defense for the next three years. The Task Force considers that in the medium term there is a need to establish a credible crisis resolution framework for the euro area capable of addressing financial distress and avoiding contagion. It will need to resolutely address the moral hazard that is implicit in any ex-ante crisis scheme. The precise features and operational means of such a crisis mechanism will require further work.[75]

2. The Bundesbank in the Greece Bailout *Case 2011*

In particular, the German *Bundesbank*, which was heard as an expert third party in the *Greece Bailout* case, had addressed the problem. The expert opinion is even repeated in the respective judgment:

> A critical view must be taken if the present European Financial Stability Facility, which is subject to a time-limit, were to become a long-term support facility. From the view point of the advocates of such a proposal, this would take better account of the fact that

[75] *See* EUR. UNION COUNCIL REPORT, Doc. No. 15302/10 (Oct. 21, 2010).

> the interconnection of the capital markets has greatly increased since the Maastricht Treaty was passed and thus the effects of economic contagion which the payment default of one state in the monetary union has on the other Member States have increased. But at the same time such a course of action would additionally weaken the personal responsibility of the national financial policies, and it would be a further step in the direction of a liability and transfer community. The risk of default on government bonds of individual Member States would be distributed among all states in the monetary union and thus the disciplining effect of the financial markets would be largely removed. The probability that with such an unsound financial policy the creditors of the state in question would call for adequate risk premiums would be reduced and thus the incentive for a cautious budgetary policy would be weakened.[76]

3. The Senate in the Greece Bailout *Case*

The most interesting detail can be found in the reasoning of the *Greece Bailout* case where the Second Senate mentioned the problem of moral hazard quite frankly. The Court held: "De facto changes, which might cast question on the binding character of this legal framework [that is, the Treaty of Lisbon], cannot at present be established by the Court; the same applies with regard to the current discussion on changes in the incentive system of the monetary union."[77]

4. Why?

So why did the Senate not say a word if it is quite obvious that the mechanisms involved were known? The reason might lie in the procedural rules. It takes a majority of justices to agree on a formulation. In cases addressing the European Union there is also a tradition that unanimous decisions are preferred, so points of disagreement can be solved by silence in a judgment. Omissions in a judgment neither mean that there is no problem, nor do they mean that no Justices recognized the problem.

[76] *See Greece Bailout* case*, supra* note 1, at para. 89.

[77] *See id.* at para. 137.

D. Tragic Irony: The FCC's Remarks on the Role of the European Central Bank

There is, however, a certain irony in the fact that the European Central Bank (ECB) is heavily criticized in the judgment. The Second Senate even took the time to announce the review of the ECB's rescue measures in the principal proceedings.

Over the strong remarks in the judgment concerning the current and future role of the European Central Bank there is a "Frankfurt" shadow hanging, since the Governing Council of the European Central Bank has taken zealous decisions on a number of technical features regarding the Euro system's outright transactions in secondary sovereign bond markets on September 6, 2012 (known as Outright Monetary Transactions or OMT).[78]

Considering how important Member states' budgetary discipline (sound state finances) is as support for an institutional framework where the European Central Bank *can* actually achieve the objective of guaranteeing stable prices in the monetary union, it seems like tragic irony that the Second Senate did not safeguard the European Central Bank. The Court omitted the assessment of an important weakening of the European Central Bank (new Article 136), but took the time to call on the Bank to "stay strong."

[78] Following the ECB's decision on Outright Monetary Transactions, the Securities Markets Programme (SMP) was terminated. *See* Press Release, European Central Bank, Technical Features of Outright Monetary Transactions (Sept. 6, 2012).